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Moving Employees from a Rep. Office to a Foreign-Invested Enterprise in Vietnam

In recent years in Vietnam, new policies and changes in the law have led to many situations where foreign companies are no longer allowed to operate as representative offices (ROs), or find that it is no longer optimal to do so. As a result, many companies are converting or considering the conversion of their ROs into full subsidiaries or "foreign-invested enterprises" (FIEs). This has been an especially hot topic in the pharmaceutical sector after changes brought on in 2017 by new legislation.

Establishing an FIE can open up new business opportunities and is recommended for companies with serious long-term commitments to Vietnam, but the shift from RO to FIE can pose its share of challenges, particularly in the area of labor and employment. A clear understanding of the conversion process will help ensure a smooth transition.

Representative Offices: A Good Place to Start

ROs are very common as a first step when foreign companies enter the Vietnam market. The RO is a quick and relatively simple way to get started, and allows the company to explore the market and establish relationships with Vietnamese businesses (distributors, agents, etc.) without a massive outlay of investment capital.

The problem with the RO is that it is only allowed to conduct a limited scope of business activities under the law. Specifically, ROs are not permitted to "directly engage in profit-making activity in Vietnam." Though such activity is not clearly defined in the law, it is understood to mean that the RO cannot provide goods or services to distributors or consumers, or collect money from them. The RO is meant to be merely a liaison office for its foreign parent company.

Though ROs have been known to find creative ways of "doing business without doing business," most companies with serious interest in the Vietnam market will eventually choose to establish FIEs in the form of limited liability companies or joint-stock companies. FIEs are allowed to conduct a much greater scope of business activities than ROs, including profit-making activities, though the licensing process is correspondingly longer and more complicated.

For some companies, the establishment of an FIE is more a necessity than a choice. For example, in the pharmaceutical sector, with the effectiveness of Decree 54/2017/ND-CP dated May 8, 2017, guiding the Law on Pharmacy (as amended) and its implementation documents, it became clear that ROs of foreign pharmaceutical companies could no longer directly employ medical representatives who conduct drug introduction activities to healthcare professionals without valid medical representative cards formally issued by the provincial department of health under the name of the RO. In turn, the provincial departments of health will no longer issue those cards to ROs, or renew the RO's existing cards, which has effectively rendered the practice impossible. As a result, these companies have been "urged" to set up their own FIEs, not only to conduct actual pharmaceutical business in Vietnam in the long run, but also to receive the medical representatives and other staff from their ROs.

Moving Employees to the FIE

In theory, once an FIE is successfully established, the RO's employees can be moved to the FIE, and the foreign investor can officially close the RO, though the procedure is not always so simple. In the pharmaceutical sector, for example, the RO may need to be maintained in parallel with the FIE for a certain period of time to ensure the smooth operations of the FIE as well as the drug export-import activity.

To move employees from the RO to the FIE, labor contracts between the RO and the employees must be terminated. To ensure a smooth migration, that should be structured as a mutual termination agreement, pursuant to which no involvement from the local labor authority or the trade union is required. A termination notice must be prepared, along with minutes of termination and liquidation of the labor contract.

To let employees go who do not agree to the mutual termination, the RO will need to prepare a "labor usage plan" to describe the situation and clearly demonstrate that the termination of the labor relationship is necessary to comply with the law. The labor usage plan must be submitted to/discussed with the appropriate-level trade union for its consideration and approval. This procedure can be rather time-consuming as Vietnamese labor law is very protective of employees and the trade unions, especially the district trade union federations, will review the labor usage plan very carefully to ensure there are no contents viewed as unfair to the impacted employees. Thus, it is always better to attempt to reach agreement on mutual termination, even if it requires additional expense.

The termination package provided to the RO's departing employees will typically include:

1. salary accrued up until the termination date;
2. a prorated portion of any 13th month salary (commonly provided in labor contracts in Vietnam);
3. unused annual leave; and
4. statutory severance allowance, where applicable.

An additional payment may be negotiated by the parties to be offered as "goodwill," and is typically determined by the seniority of the employee—for example, the employee may receive one-half month's or one month's salary for each year of employment.

The RO must then ensure that all insurance and tax obligations are fulfilled. The former employees must be deregistered with the social insurance body, and all social insurance premiums and income personal income tax for the employees must be paid up to the contract termination date.

On the FIE side, the newly established entity will sign new employment contracts with the migrated employees. In practice, the terms of these contracts should be at least as favorable as the terms in the previous contracts with the RO.

The FIE can then register the migrated employees with the social insurance body and begin paying premiums for them, and also declare the employees with the tax authority, in order to assume their personal income tax obligations.

Planning Ahead

Navigating Vietnamese labor law can be a challenge for foreign companies, as the country tends to be more protective of employees than many other jurisdictions, and requires strict adherence to formal protocol. Companies who make the decision to convert their ROs in Vietnam to FIEs would be wise to set out a step-by-step employee migration plan in advance, with the assistance of experienced advisors, to ease the transition and ensure business continuity.